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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 202

EUTERPE ECONOMOS, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

THOMAS M. WILKINS,
Counsel for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Euterpe Economos, by her attorney, Thomas M. Wilkins, Union Trust Building, Washington (5), D. C., respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fourth Circuit entered in this case.

OPINIONS BELOW.

The memorandum findings of fact and opinion are included in pages 1-4 of the Appendix and the Opinion of the

Circuit Court of Appeals (R. 33) is reported at 167 F. (2d) 165.

JURISDICTION.

The judgment of the United States Circuit Court of Appeals for the Fourth Circuit, a review of which is here sought, was entered on May 7, 1948 (R. 52).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A., Section 347(a)).

QUESTION PRESENTED.

Whether or not the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, mandatorily require denial of effect for federal income tax purposes to every transfer in trust, by a mother to her sister for the benefit of the minor children of the former, of any fractional interest in and to any unincorporated restaurant business, including its name, good will, fixtures, equipment, stock in trade and leasehold of the premises wherein the business is conducted, unless there is invested in the business, capital originating directly with the beneficiaries or the trustee, or unless the beneficiaries or the trustee contribute to the control and management of the business, or otherwise perform vital additional services in the conduct of the business.

STATUTE INVOLVED.

The pertinent provisions of the Statute are printed in the Appendix to this Petition, *infra*, pp. 20-27.

STATEMENT.

With the exception of the testimony of the petitioner (Appendix, pp. 13-17) and several brief documentary exhibits, the facts were stipulated (Appendix, pp. 5-12) and were found by the Tax Court as stipulated (Appendix, pp. 1-4). They may be summarized as follows:

Euterpe Economos, hereinafter referred to as the petitioner, and her husband, Nicholas G. Economos, in the year 1937, as equal partners, carried on a "restaurant cafeteria" business in the downtown section of Washington, D. C. (Appendix 13). The husband died intestate May 25, 1937 in that City (Appendix 14, 17).

The petitioner and her husband had two children, a daughter, Chrysanthe, born June 12, 1926, and a son, Nicholas G., born July 20, 1928 (Appendix 1, 13, 20).

Under the laws of the District of Columbia, petitioner's children inherited two-thirds of the decedent's half interest in the business and assets of the said restaurant cafeteria formerly conducted by decedent in partnership with petitioner. Petitioner inherited one-third of the decedent's half interest in the said business and assets. (Appendix 1)

This business, which had a then value of approximately $16,000, was indebted to the extent of approximately $14,000. (Appendix 14, 18)

According to the uncontradicted testimony of the petitioner, the children were in the business in 1937. (Appendix 14) In order to continue the conduct of the business in the emergency created by the husband's death while the business was so heavily indebted, and thus to save the business for the children, petitioner prevailed upon the creditors to agree to free the husband's estate from any obligation if she were to assume all the debts. (Appendix 14) Following the advice of her attorney, petitioner first purchased the children's share in the business for $7500 so that she could personally assume the obligations, which she did. (Appendix 14) Later on, when petitioner had paid all the debts of the business, she felt that it was only fair to the children to reinstate them "back in the partnership," "after the emergency for which she had bought the business was removed." (Appendix 14) Petitioner considered that because of the way the business had developed and enlarged, $7500 was a very small sum to have paid the children for their share in the business. (Appendix 14) The children

were both interested in the business and always had been "in and out and helped" her "when they were at home." (Appendix 14) At the time of the trial, the daughter was in Michigan State College and was to "graduate in June in home economics which takes in restaurants also." (Appendix 13)

The parties stipulated and the Tax Court found as a fact that "petitioner created two certain trusts, as set forth in Exhibit A and B respectively." (Appendix 5).

The parties stipulated and the Tax Court found as a fact also that petitioner and the trustee under the two trusts "entered into an agreement as set forth in Exhibit C." That agreement is the partnership agreement. (Appendix 5).

The trust agreements were identical except for the names and ages of the beneficiaries. The trust agreement in the case of the daughter is Exhibit A attached to the Agreed Statement of Facts (Appendix 5). Exhibit A is copied in full on pages 6, 7 and 8 of the Appendix. The partnership agreement, which is Exhibit C attached to the Agreed Statement of Facts, is copied in full on pages 9, 10, 11 and 12 of the Appendix. Both of the trust instruments and the partnership agreement are dated January 2, 1941.

By these instruments petitioner appointed her sister Vasilike Philadelphus trustee, conveyed to her, as trustee in each, a one-fourth undivided interest in and to the restaurant business, name, good will, fixtures, equipment, stock in trade and leasehold located at 819 - 15th St., N. W., Washington, D. C. conducted under the name of Chamberlin Cafeteria. This trustee had had years of experience in the operation of restaurants. (Appendix 6, 14, 15)

The provisions of each instrument are:

1. The trustee is to receive, hold, manage, protect, sell, invest and reinvest any and all of the property comprising the trust; to collect, recover, and receive the income; and to pay out all amounts necessary to the proper conduct or administration of the trust. (Appendix 6)

2. The trustee is empowered to sell or dispose of any property and reinvest the proceeds "as in her judgment may seem wise and proper." (Appendix 6)

3 a. When the daughter becomes 23 and the son 21, each is to receive "the entire property comprising the trust."

b. In the event of the death of either child, the trustee is to pay his or her share in the principal and accumulation to his or her issue, but in default of issue, to the brother or sister. If both die without issue during the term of the trust, the trustee is to take absolute ownership of the corpus and accumulations, "it being the purpose of this agreement to avoid any part of the said one-fourth undivided interest reverting to" petitioner. In the event of the death of Vasilike Philadelphus without issue her brother A. G. Philadelphus is to take. (Appendix 7)

4. The children may not assign or anticipate the principal or income. (Appendix 7)

5. The trust is irrevocable. (Appendix 8)

6. In the event of the inability of the trustee first named to act Ralph E. Lawrence is named to act as trustee. (Appendix 8)

7. The trustee acknowledged and accepted the trust. (Appendix 8)

Exhibit C, the partnership agreement between petitioner and the trustee, recites the creation of the trusts and the conveyance thereto of an aggregate one-half undivided interest in the business. (Appendix 9)

"The parties hereto shall, as partners, engage in and conduct a restaurant cafeteria business." (Appendix 9) The term of the partnership was to be for ten years. Petitioner under the agreement assigned to the trustee an undivided equal one-half part of the gross assets. Petitioner was to devote her full time and attention to the business, but the trustee was not obligated to devote any particular

amount of time to the business of the partnership, but her activity was left to her discretion (Appendix 10).

Petitioner was entitled to receive a drawing account against her share of the profits in the sum of $750 per month. The trustee was to be entitled to receive as a drawing account on the remaining share of the profits such amount as the parties may from time to time mutually determine. The net profits or losses are to be divided equally between the parties and the account of each is to be credited or debited, share and share alike. The parties are to have the right to withdraw the profits from the partnership and in such amounts and at such times as the parties may actually determine. In the event of the death of the petitioner her interest in the business shall forthwith succeed to and belong to the trustee as such with the same powers as conferred in the deeds of trust with full right to continue the business. (Appendix 11)

In the event of the death of the first trustee, provision is made for the appointment of an alternate trustee to carry on the business. (Appendix 11)

Upon the termination of the partnership, provision is made for the division of the assets remaining among the then partners, share and share alike. (Appendix 12)

The capital account for the daughter and the son on the books showing the share of earnings and the drawings are practically identical. The capital account for the daughter is set forth on page 3 of the Appendix.

No trust income was used to support or maintain the children. (Appendix 3)

Petitioner filed gift tax returns showing a gift to each child of a one-fourth interest in the business at values of $10,500 each. (Appendix 2)

The Commissioner in determining the deficiencies included the entire income of the restaurant business as income of the petitioner. He held that the income of the trust for the year 1941 was taxable to her under Section 167, (R. 6-7) while for the year 1943 he added that the partner-

ship was not recognized for federal income tax purposes and the income was taxable to petitioner under Section 22 (a). (R. 20-21)

The Commissioner apparently abandoned his position that the partnership income was taxable in its entirety to petitioner under Section 167 and filed an amended answer to the 1941 petition raising the affirmative issue that the income was taxable to the petitioner in its entirety under Section 22 (a) of the Internal Revenue Code. (R. 11-13)

In its opinion the Tax Court held the income from the business to be taxable in its entirety to the petitioner under Section 22 (a). No mention of Section 167 was made in the "opinion." (Appendix 4)

The Circuit Court of Appeals affirmed (R. 33), disposing of petitioner's contention that her irrevocable transfers in trust of fractional interests in her business and its assets had the effect of shifting the taxability of the income arising from such transferred interests to the transferees, with the following:

> "... We think, however, that the arrangement cannot be given this effect under the rulings of the Supreme Court...." (R. 36)

Judgment was entered April 2, 1948 affirming the Tax Court's decision (R. 39). Upon application of petitioner mandate was stayed, petition for re-hearing was filed with the court on April 30, 1948 (R. 40) and was denied by the court on May 7, 1948 (R. 52).

SPECIFICATIONS OF ERRORS TO BE URGED.

(1) The Circuit Court of Appeals erred in construing the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, as mandatorily requiring the denial of effect for federal income tax purposes to the irrevocable transfers in trust, by taxpayer to her sister for the benefit of taxpayer's minor children, of two undivided one-quarter interests in and to her unincorpo-

rated restaurant business, including all its assets, because the children and the trustee of each trust rendered no services and brought no capital to the business.

(2) The Circuit Court of Appeals erred in construing the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293 as creating a broad conclusive presumption of fact, contrary to the provision of Sections 11, 12, 161, 181, 182 and 3797 of the Internal Revenue Code, contrary to the provisions of the substantive property laws of the District of Columbia, and contrary to the stipulation of fact and the finding of the Tax Court that the two trusts were "created", the fractional interests in the business and its assets were conveyed to the trustee in each trust and that the taxpayer and the trustee of the two trusts "entered into an agreement" for the conduct of the business in partnership, thus nullifying the effect for federal income tax purposes of such irrevocable transfers in trust and the partnership agreement.

(3) The Circuit Court of Appeals erred in affirming the Tax Court's conclusions of fact in its findings (Appendix 3) which are wholly unsupported by any evidence in the record, (1) that the income of the restaurant business known as Chamberlain Cafeteria was earned by the petitioner through her own personal efforts and (2) that there was no real or genuine partnership for federal income tax purposes.

(4) The Circuit Court of Appeals erred in affirming the Tax Court's conclusion of law in its opinion (Appendix 4) which is wholly unsupported by any evidence in the record that petitioner did not actually carry on the business in partnership but conducted it as previously, by herself unaided.

REASONS FOR GRANTING THE WRIT.

1. The Circuit Court of Appeals below has decided an important question of federal law which has not been, but should be settled by this court.

The question here is: Can a trustee of two valid irrevocable trusts, existing for terms coinciding approximately with the minority of each beneficiary; wherein the income must be accumulated and distributed to each beneficiary with the corpus in approximately eight and one-half years from the date of creation; and where the grantor is without possibility of remainder, reversion, or reverter, be a "partner" in a "partnership" within the meaning of Section 3797 of the Internal Revenue Code in the conduct of unincorporated business, in which capital is a material income producing factor; where the trustee in each trust is the sister of the grantor; where the beneficiary of each trust is a minor child of the grantor; where the grantor by valid gift contributed to each trust a one-fourth undivided interest in the business and its assets; where the grantor continued to manage the business and where neither the trustee or either beneficiary contributed either services or capital in the conduct of the business?

The Circuit Court of Appeals has misconceived the application of the principles laid down by this court in the cases of *Commissioner* v. *Tower, supra,* and *Lusthaus* v. *Commissioner, supra,* by assuming that, irrespective of the good faith of the parties in giving full recognition and effect to the existence of a partnership between family members with regard to the ultimate use of the earnings and ultimate distribution thereof, no person may be regarded as a partner within the meaning of Section 3797 of the Internal Revenue Code in any business unless he performs vital additional services in the business or contributes capital originating with him in the conduct of the business. See *Mauldin* v. *Commissioner* (CCA 4), 155 F. 2d 666.

2. The decision of the Circuit Court of Appeals is in conflist with that of the Circuit Court of Appeals for the Tenth Circuit in *Armstrong* v. *Commissioner,* 143 Fed. (2d) 700 (No certiorari applied for).

In the *Armstrong case, supra,* for many years petitioner and his father had been equal partners engaged in road

construction and cattle ranching. The father died in 1937. In 1938 a new partnership agreement was prepared. The new partners were the widow and children. The then interests including those inherited in the new partnership were declared to be as follows:

Widow, 30% Petitioner, 55%

Three Children—5% each.

Petitioner made a gift to his children of his additional five percent interest in the partnership property which he inherited from his father. In order to effectuate this gift, petitioner established a trust which he set up to cover such 5% for the benefit of his two minor children in equal proportions. Petitioner made himself the trustee with all powers and management and control. The trust was irrevocable.

The Tax Court concluded that petitioner's control and management of the estate, the short trust period, the family business and relationship coupled with the fact that the son used some of the trust fund to defray his school expenses, when all considered together, constituted petitioner in reality the true owner of the trust estate.

The United States Circuit Court of Appeals for the Tenth Circuit reversed, following its own case *Jones* v. *Norris*, 122 Fed. (2d) 6, stating:

> "We do not understand that the power of management, however unlimited, may operate to bring the grantor within the sweeping provisions of Section 22(a), if by such powers he cannot derive any economic benefit therefrom, . . . the grantor retained neither the power to revoke, revest, or revert either the corpus or the income." (143 Fed. (2d) 703).

The interests involved in the *Armstrong case, supra,* and in the case below were both inherited interests. In both

cases irrevocable trusts were for the benefit of petitioner's minor children. In neither case did the interests transferred to the trust by the grantor originate with the petitioner grantor. In both cases, the grantors could not derive any economic benefit, nor did they retain power to revest, revoke or revert either the corpus or the income.

It follows, therefore, that the Circuit Court of Appeals for the Tenth Circuit decided the same question upon substantially identical facts as is involved in this case, in direct conflict with the judgment of the lower court on the question.

3. The Circuit Court of Appeals by construing the decisions of this court in the cases of *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293, as creating conclusive presumptions of fact negativing an intention to make a valid transfer in trust or to conduct the business of the restaurant in partnership with the trustee, decided this case contrary to the principles announced by this court in the case of *Heiner* v. *Donnan*, 285 U. S. 312, in violation of the due process of law clause of the Fifth Amendment to the Constitution.

4. The decision of the Circuit Court of Appeals taxing the income, which is the property of her children, to petitioner raises a federal question in a way that is probably in conflict with the applicable decision of this court in the case of *Poe* v. *Seaborn*, 282 U. S. 101. In that case, the question was who was the owner of income for the purposes of taxation under Sections 210(a) and 211(a) of the Revenue Act of 1926, which sections except as to rates correspond identically with the provisions of Sections 11 and 12 of the Internal Revenue Code quoted on page 20 of the Appendix to this Petition. In that case, although the income was earned by the appellee, Seaborn, such earnings (unlike *Lucas* v. *Earl*, 281 U. S. 111) under the laws of

the State of Washington where Seaborn and his wife resided to the extent of one-half thereof belonging to the wife under the Washington Community Property Laws, did not vest even for an instant in Seaborn. This court, therefore, held that the local laws were conclusive on the ownership of the income and hence its taxability under the federal statute. Similarly, in the instant case, the income of the business to the extent of the interest therein transferred to the trusts by petitioner, upon inception became the property of the irrevocable trusts and the beneficiaries under the property laws of the District of Columbia. Therefore, following the principles announced by this court in *Erie Railroad Company* v. *Tompkins,* 304 U. S. 64, the ownership of this income must be determined by the laws of the District of Columbia according to the ownership of the income upon its inception.

Even if petitioner did in actual fact, herself alone and unaided, produce all the income of the restaurant business with her own personal services, which she did not, in the absence of any evidence in the record to require or warrant such a conclusion, the ownership of the income from the two one-fourth undivided interests in the business and its assets did not vest in petitioner, under the laws of the District of Columbia, even for one fleeting instant. Therefore, following the decision of this court in *Poe* v. *Seaborn,* 282 U. S. 101, this fact requires the accumulated income of the trust property to be taxed to the fiduciary in accordance with the provisions of Section 161 of the Internal Revenue Code, and in accordance with the provisions of Sections 11 and 12 of the Internal Revenue Code.

ARGUMENT.

The question in this case is an important one, which should be, but has not been, settled by this court. It involves the question of the recognition of two admittedly valid trusts *inter vivos* stipulated by the parties and found as a fact by the Tax Court to have been "created". It in-

volves valid transfers to each trust "as set forth" in the stipulated exhibits (Appendix 5-12), also found as a fact by the Tax Court (Appendix 3) of a one-fourth undivided interest in the properties and going business of the restaurant, which business is of a nature in which capital is a material income-producing factor by all recognized standards. *Fairfax Mutual Wood Products Company* v. *Commissioner,* 5 T. C. 1279, 1282, *Hubbard-Ragsdale Co.* v *Dean,* 15 F. (2d) 410, affirmed 15 F. (2d) 1013, *Cotton Hotel Co.* v. *Bass,* 7 F. (2d) 900, wherein it was held that a leasehold constitutes capital, *Bowe-Burke Mining Co. et al.* v. *Willcuts,* 22 F. (2d) 204, *Vermillion Coal Co.* v. *Commissioner,* 12 B. T. A. 1161, and *Graham Flying Service* v. *Commissioner,* 167 F. (2d) 91.

Neither the findings nor opinions of the Tax Court nor the opinion of the Circuit Court of Appeals questioned the validity, existence, effect or the good faith of the trusts "created" or the transfers thereto "set forth" in the stipulated exhibits and included as part of the Tax Court's finding of fact. (Appendix 3.)

The decision of the Circuit Court of Appeals therefore has the effect of nullifying the provisions of Section 161 (Appendix 22), which require the accumulated income of the property held in trust to be taxed to the fiduciary, with exceptions not applicable here or argued as applicable here.

The decision of the Circuit Court of Appeals also has the effect of nullifying the provisions of Section 3797 of the Internal Revenue Code (Appendix 29) defining a "partnership" as including a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on and defining the term "partner" as including a member in such a syndicate, group, pool, joint venture, or organization.

Inasmuch as the stipulation and the Tax Court's finding of fact both clearly reflect the creation of the trusts, the transfers thereto of the two one-fourth undivided interests

in the restaurant business and its properties and that the petitioner and the trustee of each trust "entered into an agreement" to carry on such business "as partners" (Appendix 9), sharing the profits and losses equally (Appendix 11), and inasmuch as the business was carried on subject to that agreement (Exhibit C, Appendix 9-12) subjecting the unchallenged trust property to the risks and hazards of the business, a "partnership" resulted therefrom within the meaning of Section 3797 of the Internal Revenue Code, the petitioner and the trustee conducted themselves as "partners" within the meaning of Section 3797 of the Internal Revenue Code and the income of the trust property is required by Section 161 of the Internal Revenue Code to be taxed to the fiduciary and may not be taxed to the petitioner, unless, of course, the whole transaction constituted a sham to defraud the taxing authorities.

There is not any evidence in the record as in the cases of *Tower* v. *Commissioner*, *supra* and *Commissioner* v. *Lusthaus*, *supra*, from which the inference might be reasonably drawn that the arrangement or any part of it was a sham. There was no proof that the "end result" was that the income of the interests transferred, continued, after the creation of the trusts and partnership, to be used for family purposes, or for the benefit of the petitioner. The uncontradicted evidence, the stipulation of the parties and the finding of fact of the Tax Court all showed conclusively that the entire income of the transferred interests, which was not required for expenses of operation, was accumulated in the business for the sole benefit of the beneficiaries, to be distributed to them upon the termination of the trusts after a period of only about eight and one-half years from the time of the creation of the trusts. Under those circumstances it becomes wholly immaterial, for the purposes of testing the good faith of the arrangement, to consider whether or not the trustee or the beneficiaries or any of them contributed services of a vital character or capital originating with them, or participated in the active

conduct and management of the business. The trust instruments specifically provided that under no circumstances could the income or corpus of either trust ever revest or revert to the petitioner. (Exhibit A, Par. 3b, Appendix 7.) Under those circumstances neither the provisions of section 167 of the Internal Revenue Code or the doctrine in the case of *Helvering* v. *Clifford*, 309 U. S. 331, is applicable to the facts in the case.

No question as to the effect for income tax purposes of a transfer in trust of an interest in an unincorporated business was involved or decided in the case of *Commissioner* v. *Tower, supra* or in the case of *Lusthaus* v. *Commissioner, supra.* Nor was the definition of "partnership" or "partner" under Section 3797 of the Internal Revenue Code raised, considered or decided in either of these cases.

The decision of the Circuit Court of Appeals seems to be predicated on the premise that the *Tower* and *Lusthaus* cases made drastic changes in the substantive laws of partnerships for the purpose of administering the income tax laws. The principles outlined in those cases do not purport to prevent the formation of valid bona fide partnerships in businesses where capital is a material income producing factor, merely because of the failure of the alleged partner to perform vital services and failure of such partner to invest capital originating with him. To so hold is to construe these cases as modifying the federal law of income taxation and the local law of property, because the statute taxes income to its owner. That is to say, the statute taxes income to the person in whom, for local property purposes, the income vests immediately upon its inception. *Poe* v. *Seaborn, supra. Lucas* v. *Earl, supra,* requires no different view.

Earl had a contract with his wife for the division of *his income* with her. It had to be his first before his wife's interest in it vested. His income arose from contracts with third persons, with whom his wife had no contractional relationship. In the instant case the income of the trusts

became the income of the trusts and the beneficiaries, not because it became petitioner's income first, but because the trusts had an absolute interest under the property laws of the District of Columbia in the business itself and assets of the business which produced the income. The beneficiaries are protected from abuse by the laws of the District of Columbia. To say that all of the income of the business is petitioner's property and hence taxable to her, merely because she devoted all of her time to the management and conduct of the business, ignores the decision of this court in the case of *Paul* v. *Cullum*, 132 U. S. 539, 550, in which this court held that it is entirely competent for partners to determine, as between themselves, the basis upon which profits shall be divided and losses borne, without regard to their respective contributions, whether of money, labor, or experience, to the common stock of the partnership. It is elementary that an unincorporated business in which capital is a material income producing factor, may be carried on as a valid partnership regardless of the respective contributions of capital, labor or control. The income of a corporation is not the income of its managing stockholder with a half interest, merely because the other half interest is held in a valid trust for the benefit of such stockholder's minor children who received their stock from such stockholder by gift and who contributed no services. Why then should *Lucas* v. *Earl*, *supra*, render the income of the identical business, the income of the managing partner, when conducted as a partnership?

Section 3797 of the Internal Revenue Code defines a "person" to mean and include an individual, a trust estate, partnership, company, or corporation. In the absence of any federal statute requiring otherwise, the income of the trust from its half ownership in the going business, should be taxed to its owner, the trust, under the provisions of Sections 11 and 12 of the Internal Revenue Code.

We do not think that this court in the *Tower* and *Lusthaus* cases intended to usurp the constitutional powers

of Congress by judicially legislating changes in the federal income tax laws or the local property laws as indicated by the decision of the Circuit Court of Appeals below. We believe that this court merely intended by those decisions to affirm judicially the finding of the Tax Court in specific cases, regarding the inferences drawn by the Tax Court as reasonably justified by *all* the factors in the transactions.

In both of those cases no real change in the economic relationship of the husbands and their wives to the income in question was brought about by the partnership, principally because the income continued after as before to be devoted to the same family uses. This "end result" justified the Tax Court in looking to find some offsetting evidence of good faith. Finding none, it was held to have been justified in its holding that no real transfer had been made.

We believe that the result would have been entirely different had the wives contributed capital originating with themselves or had they contributed vital additional services. But the findings of the Tax Court in regard to those factors were *negative* or lacking. It does not necessarily follow that without some such *positive* evidence of disregard of a pretended partnership as the continued use of its income for the same family purposes after as before, courts must in all family partnership cases conclusively presume that the partnership is of no effect for income tax purposes solely because proof of contribution of capital, vital services and control by the disputed partners was *negative*. Those *negative* factors did not operate to make the presumption of bad faith arising from the disregard of the partnership any stronger, they merely failed to remove or offset the presumption of bad faith arising from the disregard of the partnership. It is elementary that such negative factors do not constitute tests of the existence or nonexistence of partnerships in which capital is a material income producing factor. *Paul* v. *Cullum, supra.*

We believe that the disregard of the partnership by the pretended partners through the continued use of its income

for the same family purposes was an indispensable *positive* factor in justifying the Tax Court's findings in those cases.

There was no such *positive* proof of disregard of the relationship in the instant case that would justify the Tax Court in looking for some positive offsetting evidence of good faith. The existence in the instant case of the irrevocable trusts to which the admittedly completed transfers of fractional interests in the going business and assets were made and the accumulation of the income for the benefit of and protection of the minor children to be distributed to them with the corpus in a few short years coinciding with the reaching of his majority, in the case of the son, and coinciding with the reaching of the age of 23, in the case of the daughter, in no sense corresponds to the *positive* factor of disregard of the partnership through the continued employment of the income for the same family purposes existing in the *Tower* and *Lusthaus* cases.

Under the circumstances, the tests of good faith in the instant case turn on whether the trusts come within the rule in *Helvering* v. *Clifford, supra* rather than whether the partnership comes within the rule in the *Tower* and *Lusthaus* cases. The instant case is removed from the application of the *Clifford* doctrine by the fact that the trust is irrevocable, that it is to terminate within only eight and one-half years from the date of its creation and that under no circumstances can the petitioner continue to use or ever use the income of the trust, as before, for her own or for family purposes. In the instant case a real change was brought about by the entire transaction. Before the formation of the trust and partnership petitioner was free to spend the entire income of the business for her own or family purposes. After the creation of the trust and the partnership she could no longer spend the entire income from the business as she pleased. Her freedom of use then became limited to the income of her retained one-half interest, while she is required to accumulate the income on the half representing the income from the children's in-

terest, or if she distributes any such income to the trustee, the trustee is required to hold the income for the benefit of the children and distribute it to them together with the corpus at the end of the short term of the trust.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

THOMAS M. WILKINS,
Counsel for Petitioner.

APPENDIX.

INTERNAL REVENUE CODE PROVISIONS
SUBCHAPTER B—GENERAL PROVISIONS

PART I—RATES OF TAX

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax of 4 per centum of the amount of the net income in excess of the credits against net income provided in section 25. (For alternative tax if gross income from certain sources is $3,000 or less, see section 400.)

[The foregoing provisions are applicable to the taxable year 1941. The provisions applicable for the year 1943 are identical except that the normal tax rate is 6 per centum instead of 4 per centum. The alternative brackets are omitted.]

SEC. 12. SURTAX ON INDIVIDUALS.

Sec. 12. (a) DEFINITION OF "SURTAX NET INCOME."—As used in this section the term "surtax net income" means the amount of the net income in excess of the credits against net income provided in section 25 (b).

Sec. 12. (b) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the surtax net income of every individual the surtax shown in the following table:

[The foregoing provisions are identical both as to 1941 and 1943. The surtax rate schedule is omitted to conserve space.]

SUPPLEMENT E—ESTATES AND TRUSTS.

SEC. 161. IMPOSITION OF TAX.

(a) APPLICATION OF TAX.—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) COMPUTATION AND PAYMENT.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

(c) CROSS REFERENCE.—

For return made by beneficiary, see section 142.

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23(o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

SEC. 167. INCOME FOR BENEFIT OF GRANTOR [AS AMENDED BY SEC. 134(a), REV. ACT 1943].

* * * * * * * * * *

(c) Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income, in the discretion of another person, the trustee, or the grantor acting

as trustee or cotrustee, may be applied or distributed for the support or maintenance of a beneficiary whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered paid out of income to the extent of the income of the trust for such taxable year which is not paid, credited, or to be distributed under section 162 and which is not otherwise taxable to the grantor.

[Sec. 134(b), Rev. Act 1943, provides as follows:

["(b) TAXABLE YEARS TO WHICH APPLICABLE.—

["(1) GENERAL RULE.—Except as provided in paragraph (2), the amendments made by subsection (a) shall be applicable with respect to taxable years beginning after December 31, 1942, unless a taxable year of the trust beginning in 1942 ends within a taxable year of the grantor beginning in 1943, in which case, except as provided in paragraph (2), such amendments shall not be applicable to such taxable year of the grantor.

["(2) RETROACTIVE EFFECT.—The amendments made by subsection (a) shall also be applicable with respect to all taxable years to which such amendments are not made applicable under paragraph (1), in the same manner as if such amendments had been a part of the revenue laws applicable to such taxable years, but only if there are filed with the Commissioner (in accordance with regulations prescribed by him with the approval of the Secretary) at such time and by such persons as may be prescribed under such regulations, signed consents that there shall be paid, at such time as the Commissioner may prescribe, all of the taxes under Chapter 1 of the Internal Revenue Code or under the corre-

sponding provisions of prior revenue laws which would have been paid for the taxable years concerned if such amendments had been a part of the revenue laws applicable to such taxable years.

["(3) DEFICIENCIES AND OVERPAYMENTS.—The period of limitations provided in sections 275 and 276 of the Internal Revenue Code or corresponding provisions of a prior revenue law on making of assessments and the beginning of distraint or a proceeding in court for collection shall with respect to any deficiency resulting from any such consents include one year immediately after the date such consents were filed, and such assessment and collection may be made notwithstanding any provision of the internal revenue laws or any rule of law which would otherwise prevent such assessment and collection. The period within which claim for credit or refund may be filed, or credit or refund allowed or made if no claim is filed, with respect to any overpayment by the grantor resulting from the consents shall include one year immediately after the date of the filing of the consents, and credit or refund may be allowed or made notwithstanding any provision or rule of law (other than this subsection, section 3760 of the Internal Revenue Code or a corresponding provision of prior law, relating to closing agreements, and section 3761 of the Internal Revenue Code or a corresponding provision of prior law, relating to compromises) which would otherwise prevent such credit or refund. No interest shall be allowed or paid on any overpayment, or assessed on any deficiency, resulting from the application of paragraph (2) of this subsection."]

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

SEC. 182. TAX OF PARTNERS [AS AMENDED BY SEC. 150(g), REV. ACT 1942].

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(b) As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME [AS AMENDED BY SEC. 150(g), REV. ACT 1942].

(a) GENERAL RULE.—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) SEGREGATION OF ITEMS.—

(1) CAPITAL GAINS AND LOSSES.—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) ORDINARY NET INCOME OR LOSS.—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

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IN THE

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No. 202.

EUTERPE ECONOMOS, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

THOMAS M. WILKINS,
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The Government in its reply brief has completely ignored the very crux of this case, which was stressed in the argument in the petition for certiorari, namely that, quite unlike the cases of *Tower* v. *Commissioner* 327 U. S. 280 and *Commissioner* v. *Lusthaus*, 327 U. S. 293, there was no proof here of a control of the *disposition* of the disputed partnership income, for the benefit or use of the petitioner. Quite on the contrary, the positive proof here shows that the beneficiaries shares of the partnership income were not disposed of and could not be disposed of by or for the benefit of the petitioner for her own purposes, including family purposes. (R. 6-8)[1]

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[1] The record citations herein designated "R" refer to the portions of the Transcript of Record. Those designated "Tr" refer to the unprinted portion of the record as certified to the court by the Clerk of the Court of Appeals for the Fourth Circuit.

Without this end result, that the petitioner controls the disposition of the partnership income, the Tax Court would not be justified in this, or any other case, in ignoring the partnership. Furthermore, without positive proof that the partnership here was but a mere pretense, it is not material that the trustee and the beneficiaries contributed no capital of their own and performed no vital services in the business. *Paul* v. *Cullum*, 132 U. S. 539, 550. It is not a usual or necessary characteristic of a trust that either the trustee or the beneficiary make such contributions of capital or services and Congress recognizes this in recognizing trusts as taxable entities. Sec. 161 of the Internal Revenue Code.

The instant case is a trust case. It should be governed by the same fundamental principles, which the Government designed as the basis for Regulations 111 Sec. 29.22 (a)-21. TRUST INCOME TAXABLE TO THE GRANTOR AS SUBSTANTIAL OWNER THEREOF.

In the case of *Helvering* v. *Clifford*, 309 U. S. 331, which involves a trust, the Government successfully argued the fundamental proposition, which is the sole issue here: who controls the disposition of the income in dispute? As stated in the *Tower* case at p. 288 of 327 U. S., the purpose of Section 22 (a)of the Internal Revenue Code is "to tax all income against the person controls its disposition" and that this purpose "could not be frustrated by family group arrangements even though • • • valid for state law purposes."

In both the *Tower* and *Luthaus* cases, supra, this identical fundamental principle was argued and applied by this Court and partnership income was taxed against the persons who *controlled the disposition* of it. That principle was also the issue in those two cases.

The above-mentioned regulations were promulgated following the *Clifford* decision, supra. These regulations, as amended, comprise a very detailed set of analytical rules for trust cases, embodying these same fundamental prin-

ciples for determining, for tax purposes, the factual question of what person *controls the disposition of income* under varying circumstances. Under these tests, as set forth in these Regulations, the petitioner here does not control the disposition of the trust income. The income here cannot be spent or used by the petitioner for her own or for family purposes. It may only be employed in the business, being accumulated with the corpus for only a short period, solely to protect the beneficiaries against their own improvidence, and to earn more income for them, after which the accumulated income and the corpus must be distributed to the beneficiaries to use as they please. (R. 6-8)

While these Regulations, as amended, purport to embody the same fundamental principles for determining the *control of the disposition of income*, which were applied by this Court in the *Clifford*, *Tower* and *Lusthaus* cases, supra, these same principles are arbitrarily avoided as tests where, as here, the creator of a family partnership is the grantor. In such cases the Government stands solely upon the mere "formalism" that a partnership is involved and refuses to be guided by the fundamental question of who *controls the disposition of the income*.

Although this case started out in the Tax Court a trust case alleged to come within the principles of the *Clifford* case. (Tr. 6, Tr. 20), the Government, immediately after the *Tower* and *Lusthaus* decisions, shifted from that premesis to the purely technical view that all underlying fundamental principles can be disregarded merely because of the "formalism" that the creator of a partnership is involved. (Tr. 11, Tr. 20). In order to do so, it has invoked the obviously false premise of attributing to this Court in the *Tower* and *Lusthaus* decisions, the supposed principle that, even in the case of a business in which capital is a material income producing factor, no partnership can exist for tax purposes between close relatives as to one who contributes neither capital of his own nor services to the busi-

ness, irrespective of who "controls the disposition of the income." No decision of this court is authority for such an arbitrary principle. Such a decision would constitute judicial legislation.

Although this is a trust case, the Government refuses to measure the particular circumstances here by its own Regulations embodying the fundamental principles for determining the one to whom it would tax the income, namely, the one who *controls the disposition of it*. Under those tests, devised by the Government itself, the income would not be taxable to the petitioner here.

The Government has deliberately avoided every discussion of those fundamental principles as applied to this case. It did not even cite the *Clifford* case in its argument before the Tax Court, the Circuit Court of Appeals below or in its brief in opposition here. While the Government stands here on a baseless "formalism", in total disregard of the fundamental principles involved in this class of cases, at the same time, it imputes to this petitioner an advocating of "the very type of formalism" by which it is avoiding the applicability of the fundamental principles which are applicable here.

On page 8 of Respondent's brief in opposition, the following statement appears:

> In the *Tower* and *Lusthaus* cases, *supra*, this Court indicated that the decisive question in such cases is not who may own a share of capital but who produced the income."

In the case of a business in which capital is a material income producing factor, this Court has never taxed the income to one who neither owned the share of capital which produced it nor controlled the disposition of the income. That is what the Government is asking this court to approve here. The above quotation constitutes an over simplification of the issue and ignores this Court's admonition in the *Tower* decision, that, "those issues cannot be decided simply by looking at a single step in a complicated transaction." What this Court said at this point in the

Tower case, was that the issue of *who produced the income* "depends upon whether this husband and wife really intended to carry on business as a partnership". And that question in the *Tower* and *Lusthaus* cases was decided, not upon who invested the capital and who performed the services, so much as it turned upon the question of the actual final disposition of the income in question, namely the "end result of the creation of a husband and wife partnership".

The "end result" of the creation of the partnerships in both the *Tower* and *Lusthaus* cases, "is that income produced by the husbands efforts continues to be used for the same business and family purposes as before the partnership." (327 U. S. 291) This factor in both the *Tower* and *Lusthaus* cases, as in *Clifford* case, conclusively disposed of the question of who *controls the disposition of the income*. It is the controlling factor in these cases, not whether or not the purported partner contributes capital of his own or performs vital services. "It is the command of the taxpayer over the income which is the concern of the tax laws". (327 U. S. 290)

In the *Tower* case, if the wife had contributed her capital from her own wealth instead from her husband's wealth, it would have followed from this Court's reasoning, that the wife was the one "who produced the income", whether she performed any services or not. But what is most important, if as here, the income could not be used for family purposes, the same as before the creation of the partnership, and if the wife had disposed of the income for herself for some use of nature other than that which "a husband usually buys for his wife such as clothes and things for the family or to carry on activities ordinarily of interest to the family as a group," (327 U. S. 286) the Tax Court would not have been justified in regarding the partnership as a pretense or a sham. If the income had not been so used, there would have been no factual basis for the assumption that the parties did not intend to carry on business as partners and the failure to contribute capital

of her own or vital services would not have been material. Proof of personal investment or contribution of vital services is material only to *rebut* the positive proof that the partnership was a sham. Lack of such investment or contribution of such services is not material, standing alone, as proof of that ultimate fact. *Paul* v. *Cullum, supra.* Standing alone, proof of such failure to invest or to perform services does not dispose of the issue here of who controls the disposition of the income.

If petitioner here controls the disposition of the income in question, it must be taxed to her as if she produced it. If the trust controls the disposition of the income for the benefit of the beneficiaries, the trust, being the owner of the capital, "produced the income" and it is taxable to the trust. That is the issue here.

In this case: (1) The fact that there were valid transfers to valid trusts was stipulated and found as a fact. (R. 3 and 5); (2) the trusts are irrevocable (R.8. par. 5); neither the corpus nor the income can revert to or be disposed of or impaired in any way by the grantor. (R. 7, par. 3.b.); (4) the income which is accumulated in the trusts and the corpus of the trusts must be distributed upon such termination solely to the beneficiaries (R. 7, par. 3.a); (5) the grantor does not control the disposition of the income of the trusts.(R. 6); and the petitioner and the trustee of the two trusts have the right to withdraw their profits from the partnership in such amounts and at such times as they may mutually determine (R. 11, par. 10).

Under the regulations, also, the disposition of the trust income is not controlled by the petitioner and the income is not her income.

The decision of the Circuit Court of Appeals below is clearly in conflict with the decision of the United States Circuit Court of Appeals for the Tenth Circuit in *Armstrong* v. *Commissioner*, 143 F. 2d. 700. The material facts in both cases are clearly "on all fours" with each other.

The decision below is in conflict with the decision of this court in *Poe* v. *Seaborn*, 282 U. S. 101, in that this court held there that the words of the statute levying a tax "upon the net income of every individual", required the income to be taxed to its owner, because: "The use of the word 'of' denotes ownership." Here, as in the *Poe* case, the income in issue never at any time vested in the petitioner under local law, nor does the petitioner have *control of the disposition of the income* in issue. In the instant case the ownership of the income is at all times vested in the trustee and the beneficiaries and never has vested in the petitioner, nor does the petitioner have control of the disposition of the income, nevertheless the decision of the court below has taxed the income to the petitioner contrary to the principle laid down in *Poe* v. *Seaborn, supra.*

It is therefore respectfully urged that a writ of certiorari be issued in this proceeding.

Respectfully submitted,

THOMAS M. WILKINS,
Attorney for the Petitioner.

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 202

EUTERPE ECONOMOS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 1-4) [1] is not reported. The opinion of the Court of Appeals (R. 32-35) is reported at 167 F. 2d 165.

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[1] The record citations herein designated "R" refer to the portions of the Transcript of Record. Those designated "Tr" refer to the unprinted portion of the record as certified to the court by the Clerk of the Court of Appeals for the Fourth Circuit.

JURISDICTION

The judgment of the Court of Appeals (R. 36) was entered on April 2, 1948. A petition for rehearing was denied on May 7, 1948. (R. 49.) The petition for a writ of certiorari was filed on August 6, 1948. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

The taxpayer, sole owner and operator of a restaurant, made a gift in trust to each of her two minor children of a one-fourth interest in the restaurant business, and simultaneously entered into a partnership agreement with the trustee under the trusts. The taxpayer continued to run the business as before; the children contributed no new capital, and neither they nor the trustee performed any vital services or participated in management.

The question presented is whether the courts below erred in sustaining the Commissioner's determination that, for Federal income tax purposes, the donor's children were not to be treated as partners, and hence that the shares of the business income attributed to the children were includible in the taxpayer's gross income.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22 [as amended by the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574, Sec. 1]. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing) of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * [26 U.S.C. 22.]

STATEMENT

The facts as found by the Tax Court (R. 1-3) are as follows:

The taxpayer and her husband conducted the business of Chamberlin Cafeteria at 819 15th Street N. W., Washington, D. C., as equal partners prior to his death in 1937. (R. 1.)

They had two children, a daughter born June 12, 1926, and a son born July 20, 1928. (R. 1.)

The husband died intestate and the taxpayer inherited one-third of his one-half interest. She paid $7,500 to his estate for the other two-thirds representing the part of the father's estate to which the two children were entitled. (R. 1.)

The taxpayer has conducted the business alone since the death of her husband. She had had training and experience in the restaurant business and has been successful in operating Chamberlin Cafeteria. (R. 1.)

The children were in boarding schools during the taxable years 1941 and 1943. They sometimes helped at the cafeteria during vacations but neither rendered any vital services or took any part in managing the business during those years. (R. 1.)

On January 2, 1941, the taxpayer created two trusts (R. 6-8) one for each minor child. She named her sister trustee of each trust. The trust deeds recited that the taxpayer conveyed a one-fourth undivided interest in the restaurant business in trust for the child until the child attained the age of 23 in the case of the daughter and 21 in the case of the son, at which time the beneficiary was to receive the interest free of the trust. The trustee had no authority to use any income except to pay the expenses of the trusts. The trusts were irrevocable and the corpus could not revert to the taxpayer. (R. 1-2.)

The taxpayer and the trustee, on the same day, entered into an agreement (R. 9-12) that they were to conduct the Chamberlin Cafeteria as partners for ten years, using the interests contributed by each. The agreement recited that "The first party hereby assigns to the second party, as trustee, as aforesaid, an undivided equal one-half part of the gross assets described in 'Exhibit A' as belonging to her for the purpose above indicated." Additional capital needed was to be contributed equally. The taxpayer was to devote her full time to the business. The trustee was not obligated to devote any of her time to the business. She lived and had full time employment in Boston, Massachusetts, and devoted none of her time to the business of Chamberlin Cafeteria. The net profits or losses were to be divided equally at the end of each year and credited to the proper accounts. The parties had the right to withdraw their profits "in such amounts and at such times as the parties may mutually determine." (R. 2.)

The balance sheet of December 31, 1940, showed the net worth of the business as $22,099.35. (R. 2.)

The taxpayer filed gift tax returns showing a gift of one-fourth interest in the business to each child at values of $10,500 each. (R. 2.)

The capital account of the trust for the daughter on the books of the business is as follows (R. 3):

Balance—Capital Account January 1, 1941		$5,524.84
Add: Share of Earnings—year ended December 31, 1941		5,839.67
		11,364.51
Less: Drawings—year ended December 31, 1941:		
Share of 1940 Excise Tax Paid	$30.42	
Guardianship Expenses	16.40	
Insurance	11.70	
		58.52
Balance—December 31, 1941		11,305.99
Add: Share of Earnings—year ended December 31, 1942		10,012.30
		21,318.29
Less: Drawings—year ended December 31, 1942		
War Bonds Purchased	$258.75	
Income Taxes	633.24	
		891.99
Balance—December 31, 1942		20,426.30
Add: Share of Earnings—year ended December 31, 1943		12,885.65
		33,311.95
Less: Drawings—year ended December 31, 1943:		
Federal Income Taxes	$5,849.23	
D. C. Income Taxes	110.18	
War Bonds	750.00	
		6,709.41
Balance—Capital Account—December 31, 1943		26,602.54

The account of the trust for the son is almost identical. (R. 3.)

No trust income was used to support or maintain the children. (R. 3.)

The Commissioner, in determining the deficiencies, included the entire income of the restaurant business in the income of the taxpayer on the ground that the partnership was not to be recognized for Federal income tax purposes and the income was taxable to her under Section 22 (a). (R. 3.)

The Tax Court sustained the action of the Commissioner (R. 4), and the Circuit Court of Appeals affirmed. (R. 32-35.)

ARGUMENT

This case is in all respects controlled by *Commissioner* v. *Tower*, 327 U. S. 280, and *Lusthaus* v. *Commissioner*, 327 U. S. 293. The decision also accords with a large number of cases in the Circuit Courts of Appeals and the Tax Court.

The case presents the rather common factual situation of a sole proprietorship, owned, operated, and controlled by the taxpayer, which is converted into a "partnership" by the use of a trust instrument conveying a one-fourth interest to each of the taxpayer's two minor children. No vital services were contributed to the alleged partnership by the trustee or the children and no capital not previously owned by the taxpayer was contributed by the trustee or the children. The business continued to be operated and controlled after the formation of the partnership in the same old way.

The earnings of the business remained on hand and available for use within the business. The trustee had no authority to withdraw income except at such times as the taxpayer and the trustee mutually agreed upon. (R. 2.) Except for the payment of taxes, only $1,000 for the purchase of war bonds for each child was withdrawn during the three year period involved; the share of the net earnings for each was in excess of $22,000. (R. 3, Tr. 40, 41.) During the same period, the taxpayer withdrew some $32,000 of about $57,000 available to her before taxes were paid. (Tr. 39.)

In the *Tower* and *Lusthaus* cases, *supra*, this Court indicated that the decisive question in such cases is not who may own a share of the capital but who produced the income. Those cases hold that family partnerships, based upon gifts of business capital, though valid and enforceable under State law, are without Federal income tax significance if the arrangement produces no substantial change in the production of the business income but merely represents a reallocation of such income within the family group. Unless the donee "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things" (*Commissioner* v. *Tower, supra,* p. 290), the conclusion is justified that the donee is not a real partner for tax purposes. The Tax Court and

the Circuit Court of Appeals below so held in the factual context of this case.

The taxpayer attempts to avoid the *Tower* and *Lusthaus* cases by suggesting that a gift in trust of a portion of a business, in which capital is a material income-producing factor, differs from an absolute gift of such an interest for the reason that the trust must be recognized as a separate taxable entity. Since a gift directly to the children would not accomplish the result sought by the taxpayer, the mere creation of a trust certainly cannot accomplish that result. To permit the tax consequences here to turn upon the considerations stressed by the taxpayer would sanction the very type of formalism which this Court and the Circuit Courts of Appeals have repeatedly refused to recognize as effectual to alter tax liability. *Belcher* v. *Commissioner,* 162 F. 2d 974 (C.C.A. 5th), certiorari denied, 332 U. S. 824; *Eisenberg* v. *Commissioner,* 161 F. 2d 506 (C.C.A. 3d), certiorari denied, 332 U. S. 767; *Hash* v. *Commissioner,* 152 F. 2d 722 (C.C.A. 4th), certiorari denied, 328 U. S. 838, rehearing denied, 328 U. S. 879; *Dawson v. Commissioner,* 163 F. 2d 664 (C.C.A. 6th); *Benson* v. *Commissioner,* 161 F. 2d 821 (C.C.A. 5th); *Losh* v. *Commissioner,* 145 F. 2d 456 (C.C.A. 10th).

Nor is there merit in the taxpayer's argument (Pet. 9-11) that the decision below is in conflict with the decision of the Circuit Court of Appeals

for the Tenth Circuit in *Armstrong* v. *Commissioner,* 143 F. 2d 700. That case, like this one, turned on its own facts; and the case, which antedated the *Tower* and *Lusthaus* rulings, has apparently been strictly limited to its precise facts by the court which decided it. Cf. *Losh* v. *Commissioner, supra.*

The taxpayer's suggestion of a conflict between the decision below and *Poe* v. *Seaborn,* 282 U. S. 101, is also insubstantial. The *Seaborn* case held that Congress had not intended to tax to one spouse his entire income in states in which community property laws gave to the other a vested one-half interest. The considerations underlying that decision are inapposite here.

CONCLUSION

The decision below is correct. There is no conflict of decisions and the case does not warrant further review. The petition should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
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SEPTEMBER, 1948.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1948 803726

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 202.

EUTERPE ECONOMOS, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

MOTION FOR LEAVE TO FILE PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIOARI.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Euterpe Economos, by her attorney, Thomas M. Wilkins, Union Trust Building, Washington (5), D. C., respectfuly moves that this Honorable Court grant leave to the petitioner herein to file the attached petition for rehearing and motion to vacate, *nunc pro tunc,* the order of October 11, 1948, denying petition for writ of certiorari.

ORDER DENYING PETITION FOR WRIT OF CERTIORARI.

The order of this Honorable Court denying petition for writ of certiorari in this proceeding was entered on October 11, 1948.

CIRCUMSTANCES ADVANCED AS GROUNDS FOR THIS MOTION.

At the time of the entry of the order denying petition for writ of certiorari herein there existed a conflict between the decision of the Court of Appeals for the Fourth Circuit in the proceeding herein, *Economos* v. *Commissioner,* 167 F. 2d 165, and the decision of the Court of Appeals for the Fifth Circuit in *W. O. Culbertson* v. *Commissioner of Internal Revenue,* 168 F. 2d 979. This ground for rehearing on order denying petition for writ of certiorari is advanced as constituting a substantial ground available to Petitioner although not previously presented.

Petitioner's counsel in the proceeding (No. 202) did not learn of the said conflict until after this Court had granted certiorari in the *Culbertson case.*

Subsequent to the said denial of petition for certiorari in the within proceeding; namely, on December 6, 1948, this Honorable Court granted a petition for writ of certiorari in the case of *Commissioner of Internal Revenue* v. *W. O. Culbertson, No. 313,* to review the decision of the Court of Appeals for the Fifth Circuit in *Culbertson* v. *Commissioner, supra,* which decision is in conflict with the decision of the Court of Appeals for the Fourth Circuit in the proceeding below, *Economos* v. *Commissioner, supra.* This ground is advanced as an intervening circumstance of substantial or controlling effect, occurring after denial of certiorari.

Respectfully submitted,

THOMAS M. WILKINS,
Counsel for Petitioner.

December 21, 1948.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 202.

EUTERPE ECONOMOS, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR REHEARING ON ORDER DENYING PETITION FOR WRIT OF CERTIORARI AND MOTION TO VACATE NUNC PRO TUNC THE ORDER DENYING PETITION FOR WRIT.

Petitioner, Euterpe Economos, by her attorney, Thomas M. Wilkins, Union Trust Building, Washington (5), D. C., respectfully petitions this Honorable Court for a rehearing on the order of October 11, 1948, denying petition for certiorari in this proceeding and respectfully moves that this Honorable Court enlarge the time for filing petition for rehearing herein to include the time for filing and acting on this motion and petition and that the Court vacate, *nunc pro tunc,* its said order of October 11, 1948, denying said petition.

ARGUMENT.

Conflict Between Circuits.

The Court of Appeals for the Fifth Circuit in its decision in *Culbertson* v. *Commissioner, supra,* on the evidence, reversed the finding of the Tax Court that there was no valid partnership as to certain alleged partners who had contributed neither capital nor services and squarely rejected the supposed legal concept attributed to this Court in the cases of *Commissioner* v. *Tower,* 327 U. S. 280 and *Lusthaus* v. *Commissioner,* 327 U. S. 293:

> ". . . that no partnership is valid—income-tax-wise—between members of a family unless the members of the family coming into the partnership actually contribute money or had actually, theretofore rendered services." (168 F. 2d at p. 983.)

This very concept of the law of partnerships for income tax purposes, quoted immediately above, which was rejected by the Court of Appeals for the Fifth Circuit in the *Culbertson case, supra,* was applied by the Tax Court in the proceeding below, where the Tax Court had rejected the petitioner's contention that the income should be taxed to the *owners of the partnership interests,* irrespective of whether they contributed capital or services to the business.

The Court of Appeals for the Fourth Circuit, in the proceeding below, in affirming the Tax Court, refused, as a matter of law, to tax the partnership income to the owners of the partnership interest, saying:

> ". . . that the arrangement cannot be given this effect under the rulings of the Supreme Court and of the Court of Appeals of this and other Circuits . . ." Citing the *Tower* and *Lusthaus* decisions of this court. (167 F. 2d at p. 167.)

By this language, the Court of Appeals below clearly followed the concept of the law of partnerships for income tax purposes, which was specifically rejected by the Court

of Appeals for the Fifth Circuit in the *Culbertson case, supra,* in taxing the income of the business "to him who owns it" (p. 984 of 168 F. 2d), irrespective of whether such owners of the income contributed capital or services to such business.

In the petition for writ of certiorari which was granted in the *Culbertson case, supra,* the Solicitor General in his third reason for granting the writ, stated:

> "The decision of the court below not only is in conflict with this court's decision in the *Tower* and *Lusthaus* cases, but reflects a marked departure from the approach taken by other Courts of Appeals and the Fifth Circuit itself in the direct wake of and even prior to this court's *Tower* and *Lusthaus* decisions." (Page 15)

In Note No. 9 (Pages 15 and 16) referring to the above quotation, in the Solicitor General's petition for the writ, as evidence of the conflict referred to in the said quotation, there appear thirty-eight cited cases including the case of *Economos* v. *Commissioner,* 167 F. 2d 165, which is the decision of the Court of Appeals for the Fourth Circuit below in the proceeding herein.

Jurisdiction.

In the petition for certiorari, among other grounds for granting the writ, petitioner contended that the decision of the court below was in conflict with that of the Court of Appeals for the Tenth Circuit in *Armstrong* v. *Commissioner,* 143 F. 2d 700 (Petition, p. 9).

The Solicitor General in his brief in opposition (filed in September, 1948) stated that there was no merit to the taxpayer's argument as to this claimed conflict (Respondent's Brief, p. 9).

On September 27, 1948, however, the Solicitor General filed petition for certiorari in the case of *Commissioner* v. *W. O. Culbertson, No. 313,* giving on page 15 as a reason for granting the writ, the conflict between the decision in *W. O. Culbertson* v. *Commissioner,* 168 F. 2d 165, in the

Fourth Circuit. This reference was obscured in a long note in small type on two pages, containing thirty-eight cited cases, of which thirty-six were not before this court at the time.

Petitioner's counsel did not learn of this recognized conflict with the *Culbertson case* until about December 13, 1948, which was after the expiration of the usual fifteen days allowed by the rules of this Court for the filing of a petition for rehearing in this proceeding (No. 202).

Therefore, on October 11, 1948, at the time that this Court considered and denied petition for certiorari in this proceeding, this Court had before it in an obscure and latent manner, the information that the decision of the Court of Appeals for the Fourth Circuit in the *Economos case*, below, was in conflict with the decision of the Court of Appeals for the Fifth Circuit in the *Culbertson case*, and that certiorari had been requested by the Solicitor General in the latter case, among other grounds, *on the ground of that very conflict*. The attention of this Court was not called to this conflict by the petitioner herein until now.

This case is unlike the case of *R. Simpson & Company* v. *Commissioner of Internal Revenue*, 321 U. S. 225, 64 Sup. Ct. 496, 88 L. Ed. 688, where this court dismissed a proceeding on which it had first denied certiorari and later granted certiorari on a petition for rehearing made out of time, three Justices dissenting.

In the case of *R. Simpson & Company*, the conflict upon which this Court relied to grant the petition for certiorari *did not exist at the time certiorari was denied and did not arise at any time during the twenty-five day period then allowed by Rule 33 for the filing of a petition for rehearing.* The conflict in that case arose in February, 1943. This Court had correctly denied certiorari on November 9, 1942 because there appeared to be no conflict, and the twenty-five day period allowed by the then Rule of the Court in which to file petition for rehearing, as of right, had expired during December, 1942.

Under these circumstances, therefore, it is clear that this court was correct in denying certiorari in the *R. Simpson & Company case* because of the lack of conflict and that no conflict had arisen until after the time for the filing, as of right, of the petition for rehearing had expired.

In the instant case, on the contrary, at the time this Court denied certiorari, it had before it the information of the existence of a conflict with the decision in this proceeding and a decision of different Circuit, which conflict had been brought to its attention obscurely in a petition for certiorari filed in the conflicting case by the Respondent in the proceeding in the instant case.

It is familiar law, that, at common law, a court has full control over its orders or judgments during the term at which they are made and may, on sufficient cause shown, amend, correct, open or *vacate* such judgments. *This power is inherent and exists independently of any statute. Judgments*, 49 C. J. S. 436, etc. In *Bronson* v. *Schulten*, 104 U. S. 410, 415, this Court stated the Rule as follows:

> "It is a general rule of the law, that all the judgments, decrees or other orders of the courts, however conclusive in their character, are under the control of the court which pronounces them during the Term at which they are rendered or entered of record, and may then be set aside, vacated, modified or annulled by that Court."

In *Bassett* v. *United States*, 9 Wallace 38, 41, in which the action of a court in setting aside a judgment at the same term at which it was rendered was sustained, this Court said:

> "This control of the court over its own judgment during the term is of every day practice."

In *Henderson* v. *Carbondale Coal & Coke Company*, 140 U. S. 25, 40, 11 Sup. Ct. 691, 696, this Court said:

> ". . . where a judgment or decree is set aside at the term at which it is rendered *it is as though it had never been.*" (Italics ours).

Neither this latter case nor the principle of the *nunc pro tunc* effect of vacating orders was mentioned in the opinion of the court or the dissenting opinion in the case of *R. Simpson & Company, supra.*

When Congress enacted the provisions of Sec. 1140, which provide that the decision of the Tax Court shall become final "upon the denial of a petition for certiorari, if the decision of the Tax Court has been affirmed. . .", it must have had in mind this well-recognized rule under which the Supreme Court of the United States has inherent power to vacate its orders rendered during the term denying petition for writ of certiorari and that the court's judgment or decree in vacating such denial of certiorari is as though the denial "had never been." If Congress, by the enactment of Sec. 1140, had intended to curtail the inherent power of the Supreme Court to modify or set aside its denial of certiorari during the term, it certainly would have said so in clear language, but having said nothing in this regard, it must be assumed that when the Supreme Court reconsiders its denial of certiorari on the basis of circumstances, which were in existence at the time of denial, which required that the petition be granted, it must be assumed in such circumstances that Congress intended that the Supreme Court could exercise its inherent power to make the correction during the term by vacating its order denying certiorari, and that the original erroneous denial of certiorari would be "*as though it had never been.*" *Henderson* v. *Carbondale Coal & Coke Company, supra.*

In the case of *R. Simpson & Company, supra*, this Court's Rule 33 with respect to rehearing included no separate and specific reference to rehearings of orders on petitions for writs of certiorari.

On October 14, 1947, however, this Court modified its Rule 33 with respect to rehearing, adding a new provision, effective January 1, 1948, specifically relating to rehearing "Of orders on petitions for writs of certiorari," reading as follows:

"2. Of orders on petitions for writs of certiorari. A petition for rehearing may be filed with the clerk in term time or in vacation, subject to the requirements respecting time, service, printing and number of copies furnished as provided in paragraph 1 of this rule. Any petition filed under this paragraph must briefly and distinctly state grounds which are confined to intervening circumstances of substantial or controlling effect (e.g., *Sanitary Refrigerator Co. v. Winters*, 280 U. S. 30, 34, footnote 1; *Massey v. United States*, 291 U. S. 608), or to other substantial grounds available to petitioner although not previously presented (e.g., *Schriber-Schroth Co. v. Cleveland Trust Co.*, 305 U. S. 47, 50). Such petition is not subject to oral argument. A petition for rehearing filed under this paragraph must be supported by a certificate of counsel to the effect that it is presented in good faith and not for delay, and counsel must also certify that the petition is restricted to the grounds above specified.

"(a) A response, if printed and forty copies thereof furnished, accompanied by proof of service, may be filed with the clerk within ten days after service of petition, unless the time is shortened or enlarged by the court or a Justice thereof."

It is not unlikely that this new "intervening circumstances" phrase may have been inserted under this Court's inherent power, during term, to vacate orders denying petitions for certiorari so as to do justice should circumstances similar to those involved in the *R. Simpson & Company case* arise in the future.

This Court's inherent power to vacate its orders during the term is consistent with the present procedural rule of determination recently outlined by Congress, and effective September 1, 1948, by Sec. 2106 of Title 28 U. S. C. That section reads as follows:

"The Supreme Court or any other court of appellate jurisdiction may affirm, modify, vacate, set aside or reverse any judgment, decree, or order of a court *lawfully brought before it for review*, and may remand the cause and direct the entry of such appropriate judg-

ment, decree, or order, or require such further proceedings to be had as may be just under the circumstances. (Act of Congress, approved June 25, 1948.)" (Italics ours.)

While it might be said that, under old Rule 33, the order which was vacated in *R. Simpson & Company, supra*, was not "lawfully brought before it for review", (within the meaning of Sec. 2106), because the old Rule did not provide specifically for reviewing *orders on petitions for writs of certiorari*, this criticism cannot be made with respect to a petition for rehearing on petition for writ of certiorari brought out of time but within the circumstances outlined in the present Rule and within the time as enlarged by the Court or a justice thereof.

Sec. 1141 (c)(2) of Title 26 U. S. C. specifically empowers the courts, including the Supreme Court of the United States, in the review of Tax Court cases, "to adopt rules for the filing of the petition for review, the preparation of the record for review, *and the conduct of the proceedings upon such review.*" (Italics supplied) This provision certainly authorizes this court to promulgate its present Rule No. 33 and, unless the denial of a petition for certiorari is so final under Sec. 1140 (b)(2) as to nullify even the fifteen day rule for filing petition for rehearing, the provision in Rule 33 for the enlargement of that time is effective, with an order vacating the order denying a petition for certiorari, to nullify the previous denial of certiorari *"as though it had never been"*. *Henderson* v. *Carbondale Coal & Coke Company, supra.*

If the denial "had never been", the Tax Court's decision never became final and is a nullity. But the Revenue laws are so framed that no one can be hurt by the *nunc pro tunc* effect of any vacating order, as will be shown below.

The statute of limitations for the assessment and collection of federal income taxes is suspended by the provisions of Sec. 277 of Title 26 U. S. C. for the period during which the Commissioner is prohibited from making the assess-

ment or beginning a distraint or a proceeding in court *until the decision of the Tax Court becomes final, and for sixty days thereafter,* and the Tax Court's affirmed decision becomes final upon denial of certiorari, under Sec. 1140 (b)(2), Title 26 U. S. C.

It is impossible to see how any rights could be prejudiced by the vacating of an order denying petition for certiorari, when the vacating order would have the effect of nullifying such previous order denying the writ, because "it would be as though it had never been." On the basis of the subsequent order vacating the denial, *the suspension of the statute would remain in effect as though no denial had occurred.*

The discussion in the majority opinion of this Court in *R. Simpson & Company, supra,* deals with the finality of Tax Court decisions in relation to the statute of limitations. It goes into that part of the legislative history covering the finality provision without covering that part dealing with the effect of the suspension of the statute of limitations during the period during which for any reason at all, the Commissioner was prevented from assessing or collecting the tax. (See Report of Ways and Means Committee, 70th Cong., 1st Sess., H. Rept. 2, pages 23 and 24.)

Section 277 of the Revenue Act of 1928 (Act of May 29, 1928, C. 852, 45 Stat. 791-883, Title 26 U. S. C. Revenue acts of 1924 to date 1940 ed. p. 431) now Section 277 of Title 26 U. S. C., was changed to provide for the suspension of the statute in cases where "the paper filed (as a petition with the Board) within the period was not sufficient to constitute a petition." At the same time it was further suggested to the Committee on Ways and Means that language also be inserted to show that the running of the statute should be suspended not only when the Commissioner is under the prohibitions of Section 272 (a), now Section 272 (a) of Title 26 U. S. C., but also when the Commissioner is restricted by order of court from making assessment or collection.

The Committee refused to make any other change in the statute, because it felt that the language of the statute was perfectly definite on this point and that no clarification was necessary. It stated that the language "clearly indicated that the intention was to suspend the running of the statute for the period during which, *for any reason at all*, the Commissioner's hands were tied." (H. Rept. 2, *supra.*) (Italics ours)

The meticulous formula for the suspension of the statute in Tax Court cases, clearly evinces the most careful intention on the part of Congress to protect the rights of both parties until after the litigation has come to an irrevocable termination.

Consider the following possibilities:

(a) Where the vacated order incorrectly determined a deficiency of only $1,000 and the eventual final order correctly determines a deficiency of $2,000, the prohibition against any assessment or collection would have existed until the incorrect order for a $1,000 deficiency became "final." From then on there would continue a prohibition against the assessment or collection of any sum *in excess of $1,000*, suspending the statute as to such excess.

(b) Where the vacated order incorrectly determined a deficiency of $2,000 and the eventual final order correctly determines a deficiency of only $1,000 vacating the first "final order", the Commissioner might assess and collect the entire $2,000 before the entry of the vacating order, in which case the parties would be in the same position upon entry of the original order and until it was vacated, as if the taxpayer had given a waiver of the Commissioner's restrictions against assessment and collection under Section 272 (d) of Title 26 U. S. C. and eventually, the excessive $1,000 would be refundable through Tax Court order or even suit, under Section 322 (c)(2) of Title 26 U. S. C. as an "amount collected in excess of an amount computed in accordance with the" Tax Court's decision, which has become final.

If the Commissioner did not have time, after the original erroneous final order was entered, to assess and collect the $1,000 under circumstances in (a) or the $2,000 under circumstances in (b), before the vacating order was entered, the prohibition against assessment and collection would be reinstated *nunc pro tunc* by the vacating order but the *suspension* of the statute would remain unbroken any way.

Whether the vacated order is regarded "as if it had never been" or as if it possessed enduring effect although vacated, the statute would have been *suspended* under either view, while the order was in effect, because the statute is suspended under Section 277 of Title 26 U. S. C. until the decision of the Tax Court becomes final "*and for sixty days thereafter*". In practice the Commissioner assesses and collects the deficiency during the sixty day period.

Therefore it cannot be argued consistently that: (1) There was no suspension under the sixty day clause because the vacating order made that suspension "as though it had never been" and (2) because, *except retrospectively*, there was no prohibition against assessment and collection between the time of the entry of the later vacated order and the time of the entry of the order vacating it, and that therefore there was no suspension of the statute during that intervening period.

Under one view or the other there must have been an unbroken continuation of the suspension of the statute during the entire period and until the litigation has come to a termination not later revoked.

Specifically in the instant case, no bond was filed and the deficiency was assessed and collected while the proceeding was pending in the Court of Appeals. Assuming that the order denying the writ is vacated *nunc pro tunc* and the decision of the Tax Court is reversed, and permitted to become final, the amount already paid would be refundable under Sec. 322 (c)(2) as an "amount collected in excess of an amount computed in accordance with the decision of the Board which has become final. . ."

In enacting Sec. 1140 (b)(2) of Title 26, U. S. C., Congress certainly must have been conscious of the *nunc pro tunc* effect of an order vacating an order denying a petition for certiorari. It must have regarded the provisions of said Sec. 277 and Sec. 322 (c)(2) of Title 26, U. S. C. as sufficient to protect the rights of either party in such cases, otherwise it would have inserted some provision similar to the amendment of Sec. 277 first contained in Sec. 277 of the Revenue Act of 1928 (Act of May 29, 1928, C. 852, 45 Stat. 791-883), to regard a wholly defective paper "placed on the docket of the Board" as sufficient to suspend the statute of limitations for assessment and collection of the tax. See Report of Committee on Ways and Means, 70th Cong., 1st Sess., H. Report 2, pp. 23-24. See also Seidman's Legislative History of Federal Income Tax Laws (1938 Edition) pp. 551, 552.

CONCLUSION.

In view of the above circumstances and because of the conflict hereinabove relied upon, it is earnestly prayed that the motion for leave to file petition for rehearing be granted, that the time for filing petition for rehearing on the order on petition for certiorari in this pending be enlarged to protect this motion and petition; that the order denying petition for certiorari in this proceeding be vacated and set aside *nunc pro tunc* and that the petition for certiorari be granted.

THOMAS M. WILKINS,
Counsel for Petitioner.

CERTIFICATE OF COUNSEL.

I, Thomas M. Wilkins, counsel for petitioner in the proceeding herein. do hereby certify that this motion for leave to file petition for rehearing and the petition are presented in good faith and not for delay and that the motion is restricted to intervening circumstances of substantial controlling effect and to other substantial grounds available to petitioner although not previously presented.

THOMAS M. WILKINS,
Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 202.

EUTERPE ECONOMOS, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

SUPPLEMENTAL MEMORANDUM TO MOTION FOR LEAVE TO FILE PETITION FOR REHEARING.

JURISDICTION.

This supplemental memorandum is respectfully presented to call attention to the inadvertent misstatement of the history of Section 1140, Title 26, U.S.C., which this Court adopted as part of its majority opinion in *R. Simpson & Son Inc.* v. *Commissioner*, 321 U. S. 225 at page 228, from Senate Report No. 52, 69th Congress, 1st Session, page 37, reporting on Section 1005 of the Bill, which became the Revenue Act of 1926. (Act of Feb. 26, 1926, C. 27, 44 Stat. 9-131.) Said Report No. 52 is dated January 16, 1926.

Under the Bill, in its original form, the importance of the Finality provisions of Section 1005, bore a direct relation to the statute of limitations in terms of extension in Board of Tax Appeals cases, where notice of deficiency would be mailed.

Section 277(b) of the original draft provided that the Statute of limitations for assessment and collection

> " . . . shall be extended (1) by 60 days if a notice of such deficiency has been mailed . . . and no petition has been filed . . . or, (2) if a petition has been filed, then by the number of days between the date of the mailing of such notice and the date the decision of the Board has become final." (Draft of December 7, 1925, accompanying H. Rept. 1, 69th Cong., 1st Sess. Union Calendar No. 1. See draft of Bill page 124, lines 3-14.)

The use of the language measuring a suspension by the period during which "the Commissioner is prohibited" from assessing and collecting the tax, was first introduced in a later draft. (See page 124, lines 9-15 of December 21, 1925 draft as referred to Senate Finance Committee.)

The House Ways and Means Committee Report accompanying the Bill, explained the provisions dealing with "Court Review—Finality of Decisions—", which became Section 1005 of the Revenue Act of 1926. This explanation employed language appropriately couched to fit the original draft of Section 277(b) of the Bill. However, that explanation eventually became quite inappropriate to the modified draft of the Bill as it was when it left the Senate Finance Committee with its Report No. 52, *supra*, and as it finally passed. See page 136, lines 12-25 and page 137 lines 1-7 of January 16, 1926 draft of Bill, accompanying said Sen. Rep. No. 52.)

The reasons for the enactment of the Finality provisions which were given in the House Report on the Bill had become obsolete and quite inapplicable by the time the provisions of the draft of Section 277(b) had been modified to substitute the word "suspended" for the word "extended" and to adopt as a measure of such suspension, the period during which, in so many words, the Commissioner was "prohibited" from assessing and collecting the deficiency. This suspension formula was adopted in place of an extension for so many days.

These changes and the addition in the Senate Finance Committee, of an additional sixty day period within which to assess and collect *after the Board's decision had become*

final, rendered the explanation of the finality provisions of Section 1005 as it finally passed substantially erroneous. In fact it was erroneous when Senate Report No. 52, 69th Cong., 1st Sess., pp. 37-38, was issued.

Inasmuch as there had been no *direct change* in the Finality provisions *themselves,* in the matter of suspension, the said Report No. 52 at pages 37 and 38, apparently overlooked the *indirect changes* brought about in the reasons originally given by the Ways and Means Committee for the enactment of the Finality provisions. This may explain why the Senate Committee erroneously adopted, almost word for word, the House Report on the Finality provisions. (H. Rept. 1, 69th Cong., 1st Sess., pp. 20-21.)

Specifically, the Senate Finance Committee Report stated, quite erroneously, that the "statute of limitations upon assessments and suits for collection, . . . commences to run upon the day upon which the Board's decision becomes final . . . "

Furthermore, on February 5, 1926, Section 277(b) was further amended (by an amendment on the Senate Floor) adding the phrase "and for 60 days thereafter", striking the more cumbersome language to the same effect. (Vol. 67, Cong. Rec., p. 3378.)

As the 1926 Revenue Act was finally passed, the statute of limitations does not commence to run "upon the day upon which the Board's decision becomes final." It does not commence to run until sixty days thereafter.

This erroneous report is the report which this Court quoted in its majority opinion as containing the historical reason for the Finality provision which is now Section 1140 of Title 26 U.S.C.

The importance of "finality" *in relation to suspension* in the modified draft had disappeared, as the result of the changed Section 277(b), which then and now measures the suspension by the period during which, in so many words, the Commissioner is "prohibited" from making the assessment or collection.

Inasmuch as the suspension *is intended to apply if for any reason at all the Commissioner's hands are tied,* (House Ways and Means Committee Report No. 2, 70th Cong., 1st Sess., pp. 23-24, also House Ways and Means Committee Report 356, 69th Cong., 1st Sess., p. 42) in the matter of assessment or collection, the date of finality can have importance only to permit the Commissioner to assess and collect the deficiency determined, which has become final.

It is now important for the Commissioner to know exactly when the decision becomes final, only because Section 272(a) of Title 26 U.S.C. prohibits assessment in Tax Court cases until the decision becomes final. As the Commissioner's hands are then no longer "tied", he does not have to postpone assessment and collection perhaps nearly a year, until the end of the term of court to determine whether or not, for any reason, the court might vacate or set aside an order determining a deficiency which has become final.

For the purposes of orderly administration, in the usual case, Section 1140 (b) and 1140 (c), the Commissioner's hands are tied for an additional 30 days, in court review cases, to permit time for the institution of proceedings to have the decision corrected. After that, for administrative purposes, the Commissioner may then assess and collect the deficiency determined. If, thereafter, but during the term, the decision is later vacated, the "final" order which untied the Commissioner's hands, might be vacated and any amount which had been collected in excess of the deficiency later finally determined, may be refunded under Section 322 (c) (2) of Title 26, U. S. C. See discussion on pages 11, 12 and 13 of Motion to Leave to File Petition for Rehearing.

Respectfully submitted,

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December 28, 1948.